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Cases, Regulations and Statutes

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method and convention as the exchanged (or involuntarily converted) property *with respect to so much of the taxpayer's basis in the acquired property as does not exceed the taxpayer's basis in the property given up.*[10] To the extent basis in the acquired property exceeds the income tax basis of the exchanged property, the acquired property is treated as newly purchased MACRS property.[11] Thus, two separate depreciation deduction schedules are needed—one for the carryover basis over the remaining recovery period and one for the portion of the basis attributable to the cash paid which is depreciated as newly purchased property over the recovery period for the acquired asset.

Example: Returning to the above example of a trade of a 1996 tractor (which had been depreciated down to $18,000) for a new 2000 tractor with a $92,000 cash payment, the $18,000 amount continues to be depreciated as seven-year property beginning with the date the 1996 tractor was placed in service, using the depreciation method and convention as had been used for the 1996 tractor.

The $92,000, less any amount claimed as expense method depreciation, would be entered for the 2000 tractor as a newly purchased asset. Thus, the new tractor would be depreciated under the recovery period, convention and depreciation method appropriate for a tractor placed in service on August 1, 2000. Thus, the taxpayer's depreciation schedule would now reflect two entries. One entry, in effect, reflects the continuing depreciation on the tax investment in the 1996 tractor. The other entry would show the new tax investment in the 2000 tractor.

Effective date

For acquired MACRS property placed in service on or after January 3, 2000, the principles in Notice 2000-4[12] must be followed.

Property placed in service before that date, for which the entire basis for the acquired property is treated as newly purchased property, can continue with that approach.[13] For such property to be shifted to Notice 2000-4 principles is a change of accounting method.[14] Those taxpayers who shift to Notice 2000-4 must have acquired the property in a like-kind exchange or by involuntary conversion, be presently treating the property as newly purchased MACRS property, make the change for the first or second tax year ending after January 3, 2000, and treat the shift as an automatic change of accounting method.[15] If depreciation under Notice 2000-4 results in more depreciation allowable than what was actually taken, the difference is a Section 481 adjustment that must be taken into account under *Rev. Proc. 99-49*.

In conclusion.

The major impact of Notice 2000-4[17] is likely to be in the additional complexity in handling entries on the depreciation schedule. The Notice will have an impact, also, on the timing of depreciation deductions, depending upon the facts of each situation.

FOOTNOTES

1 Notice 2000-4, I.R.B. 2000-3, 1.

2 I.R.C. § 1031. See generally 4 Harl, *Agricultural Law* § 27.03[8][a][ii](2000); Harl, *Agricultural Law Manual* § 4.02[16](2000).

3 I.R.C. § 1033. See generally 4 Harl, supra note 2, § 27.04.

4 I.R.C. § 1031(d). See 4 Harl, supra note 2, § 29.04[1][b].

5 I.R.C. § 179. See 4 Harl, supra note 2, § 29.05[2][b].

6 See I.R.C. § 179(b)(1) (the maximum expense method depreciation for 2000 is $20,000).

7 I.R.C. § 1033(a).

8 I.R.C. § 1033(a)(1).

9 I.R.C. § 1033(b).

10 Notice 2000-4, I.R.B. 2000-3, 1.

11 *Id*.

12 I.R.B. 2000-3, 1.

13 *Id*.

14 *Id*.

15 See Rev. Proc. 99-49, I.R.B. 1999-52, 725.

16 *Id*.

17 I.R.B. 2000-3, 1.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

FEDERAL TAX-*ALM* § 13.03[7].*

DISCHARGE. After losing a Tax Court case which held that the debtor owed taxes, the debtor married his long-time companion and executed an antenuptial agreement which transferred all of the assets of a corporation owned by the debtor to the debtor's spouse's corporation. In return, the spouse transferred to the debtor debts owed to her by the debtor. Neither set of assets had much value because the debtor's corporation had been incurring substantial losses. However, because the debtor's corporation owned the debtor's residence and vehicles, the antenuptial agreement effectively removed from the debtor's estate all assets against which the IRS could levy to satisfy the Tax Court judgment. The IRS petitioned for nondischarge of the debtor on the tax claims for willful and fraudulent attempt to evade taxes. The court held that the tax debt was nondischargeable because the intentional and voluntary transfer of the debtor's assets without adequate consideration to a family member was a willful and fraudulent attempt to evade taxes. On appeal, the appellate court initially reversed, holding that, under *In re Haas, 48 F.3d 1153 (11th Cir. 1994)*, the mere non-payment of taxes did not amount to a willful attempt to evade taxes under Section 523(a)(1)(C). The appellate court had expressed reservations about the wisdom of *Haas* under the facts of this case but felt compelled to follow *Haas*. On

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rehearing en banc, the appellate court affirmed the District and Bankruptcy Courts, holding that Haas was still correct but reviewed the case using the test of whether the debtor knowingly, voluntarily and intentionally violated a duty under the law. The court held that the evidence of the debtor's attempt to hide assets was sufficient that the debtor voluntarily and intentionally failed to fulfill the duty to pay the taxes. ***In re*** **Griffith, 206 F.3d 1389 (11th Cir. 2000), *rev'g on reh'g en banc*, 174 F.3d 1222 (11th Cir. 1999), *rev'g*, 210 B.R. 216 (S.D. Fla. 1997), *aff'g*, 161 B.R. 727 (Bankr. S.D. Fla. 1993)**.

The debtor failed to file and pay income taxes for 10 years, during which the debtor suffered from alcoholism. The court found that the debtor did no affirmative acts to avoid payment of the taxes but that the debtor was merely indifferent to paying the taxes, a condition caused by the alcoholism. Once the debtor sought treatment for the alcoholism, the debtor fully cooperated with the IRS and filed all of the unfiled returns. The court held that the taxes were dischargeable because the debtor did not willfully attempt to evade payment of the taxes. The court reiterated the holding in *In re Haas, 48 F.3d 1153 (11th Cir. 1997)* that the mere failure to file and pay taxes when able to do so was not sufficient to render the taxes nondischargeable. ***In re*** **Fretz, 248 B.R. 183 (N.D. Ala. 2000), *aff'g*, 239 B.R. 605 (Bankr. N.D. Ala. 1999)**.

Although the debtor had filed income tax returns for several years, the debtor stopped filing returns and paying taxes after deciding that the IRS had no authority to collect taxes. The debtor continued to refuse to file returns or pay taxes after assessments by the IRS. The debtor attempted to hide assets from the IRS by using sham trusts and false business names for bank accounts and avoiding the use of checks. Criminal charges were eventually brought against the debtor who still resisted filing the returns. Eventually the debtor did file returns but only under court orders. The court held that the taxes were nondischargeable under Section 523(a)(1)(C) for willfully attempting to evade payment of taxes. ***In re*** **May, 247 B.R. 786 (Bankr. W.D. Mo. 2000)**.

EARNED INCOME CREDIT. The debtor filed for Chapter 7 in October 1997 and included an exemption for the entire 1997 earned income credit. The debtor argued that the earned income credit was not estate property because the debtor was not entitled to the credit as of the petition filing. The court held that the debtor had sufficient interest in the credit on the petition date to include the credit in estate property. ***In re*** **Johnston, 209 F.3d 611 (6th Cir. 2000), *aff'g unrep. D. Ct. dec. aff'g*, 222 B.R. 552 (Bankr. 6th Cir. 1998)**.

REFUNDS. In a Chief Counsel's Advice letter, the IRS discusses the issues involved in whether the IRS may be ordered to pay individual tax refunds to Chapter 13 trustees. The letter, however, does not include any of the legal conclusions reached. **CCA Ltr. Rul. 200027049, May 12, 2000**.

SETOFF. The debtor filed a Chapter 13 plan which provided for full payment of an IRS claim for 1996 taxes. The debtor's schedules listed a federal tax refund which the debtor claimed as exempt property. The plan was confirmed without objection from the IRS but on the very next day, the IRS filed a motion to offset the tax refund against the 1996 tax claim. The Bankruptcy Court held that the confirmation of the plan established the rights between the debtor and IRS and prevented any setoff. The District Court reversed, holding that the provisions of a confirmed plan cannot alter a creditor's right of setoff under Section 553. ***In re*** **Munson, 248 B.R. 343 (C.D. Ill. 2000), *rev'g*, 241 B.R. 410 (Bankr. C.D. Ill. 1999)**.

TAX LIEN. The debtors filed for Chapter 7 and listed an IRA as exempt property, although the schedules did not identify the location of the IRA. The IRS was listed as a creditor, attended the creditors' meeting, and did not object to the exemption schedule. More than 30 days after the creditors' meeting, the debtors withdrew the IRA funds in several installments and deposited the funds in several other accounts. The debtors then used the funds to pay nondischarged debts, including estimated taxes for the post-petition tax year. After the debtors received their discharge, including discharge of taxes for which the IRS filed a tax lien, the IRS sought to enforce the tax lien against the IRA funds, but by the time the IRS traced the funds to the separate accounts, none of the funds remained in the accounts. Instead, the accounts had funds only from post-discharge income of the debtors. The IRS levied against those funds which were eventually paid to the IRS. The debtors sought return of the funds, damages, attorney's fees and costs. The court held that the levy against post-discharge funds violated the permanent injunction resulting from the discharge. The court ordered that the levied funds be returned to the debtors; however, the court refused to award any damages or costs. The IRS argued that equitable principles of tracing and constructive trust should be applied to allow the recovery of the dispersed IRA funds, which were subject to the lien, from the post-discharge income, which was not subject to the lien. The court rejected this argument because the debtors' actions were not fraudulent. ***In re*** **Wood, 247 B.R. 493 (Bankr. M.D. Fla. 1999)**.

FEDERAL AGRICULTURAL PROGRAMS

ANIMAL WELFARE. The APHIS has announced that it is considering several changes to the animal welfare regulations to promote the humane treatment of live animals used in research, testing, and teaching and to improve the quality of information reportED to Congress concerning animal pain and distress. Specifically, APHIS is considering adding a definition for the term "distress." Although this term is used throughout the animal welfare regulations, it is not defined. APHIS stated that the addition of such a definition would clarify what is considered to be "distress" and could help assist research facilities to recognize and minimize distress in animals in accordance with the Animal Welfare Act. APHIS is also considering replacing or modifying the system used to classify animal pain and distress. Professional standards regarding the recognition and relief of animal pain and distress have changed significantly since the establishment of the classification system. **65 Fed. Reg. 42304 (July 10, 2000)**.

CROP INSURANCE. The FCIC has issued interim regulations amending the catastrophic risk endorsement to revise the definition of "approved yield" to allow for the substitution of 60 percent of the transitional yield, change the administrative fee from $60 to $100, revise the requirement that the producer pay the administrative fee, and remove all references to limited coverage because, as a result of changes to the subsidy levels and administrative fee, there is no longer a distinction between limited and additional coverage. The interim regulations also amend the group risk plan of insurance regulations to remove all references to limited coverage because, as a result of changes to the subsidy levels and administrative fee, there is no longer a distinction between limited and additional coverage; revise the definition of "additional coverage" to incorporate limited coverage; change the administrative fee from $60 to $100 for catastrophic risk protection coverage, remove all references to administrative fees for limited coverage, change the administrative fee from $20 to $30 for all coverages in excess of catastrophic risk protection; and revise the requirement that the producer pay the administrative fee. The interim regulations also amend the common crop insurance regulations to remove all references to limited coverage because, as a result of changes to the subsidy levels and administrative fee, there is no longer a distinction between limited and additional coverage; revise the definition of "additional coverage" to incorporate limited coverage and the definition of "approved yield" to allow for the substitution of 60 percent of the transitional yield; remove all references to administrative fees for limited coverage, and change the administrative fee from $20 to $30 for all coverages in excess of catastrophic risk protection; and revise the requirement that the producer pay the administrative fee. **65 Fed. Reg. 40483 (June 30, 2000)**.

The FCIC has announced the approval for reinsurance and subsidy the insurance of canola/rapeseed, corn, feed barley, soybeans, sunflowers, spring wheat, and winter wheat in select states and counties under the Revenue Assurance plan of insurance for the 2001 crop year. **65 Fed. Reg. 41930 (July 7, 2000)**.

The FCIC has announced the approval for reinsurance and subsidy the insurance of corn, grain sorghum, soybeans, cotton, rice, and wheat in select states and counties under the Crop Revenue Coverage (CRC) plan of insurance submitted by American Agrisurance (AmAg). **65 Fed. Reg. 41937 (July 7, 2000)**.

SHARED APPRECIATION AGREEMENTS. The plaintiff had obtained an emergency farm loan in the 1970s and had defaulted on the loan in 1988. The plaintiff obtained loan servicing and signed a shared appreciation agreement with the FmHA (now FSA). The county office set a valuation on the plaintiff's farm property for purposes of determining the basis for appreciation over the 10 years of the agreement. In 1998, the 50 percent appreciation payment came due and the terms of the agreement were audited by the FSA which determined that the original valuation was erroneously adjusted upward by the county office. The FSA ruled that the plaintiff had received "unauthorized assistance" and increased the amount of appreciation and the 50 percent payment required. The issue in this case was whether the FSA acted properly in adjusting the initial valuation of the property. The court held that the regulations governing shared appreciation agreements provide no authority for rewriting the agreements but require the FSA to make a determination of unauthorized assistance and initiate a separate collection adjudication. **Viers v. Glickman, No. 4-99-CV-90431 (S.D. Iowa July 10, 2000)**.

TOBACCO. The CCC has adopted as final regulations for the 1999 marketing quota for tobacco:

Kind and Type	Quota (Million pounds)
Virginia fire-cured(type 21)	2.6
Ky-Tenn. fire-cured(types 22-23)	41.4
Dark air-cured(types 35-36)	12.8
Virginia sun-cured(type 37)	0.171
Cigar filler & binder(types 42-44, 53-55)	4.5

The 1999 tobacco price support levels were as follows:

Kind and Type	Cents per pound
Virginia fire-cured(type 21)	155.9
Ky-Tenn. fire-cured(types 22-23)	171.6
Dark air-cured(types 35-36)	148.1
Virginia sun-cured(type 37)	138.0
Cigar filler & binder(types 42-44, 53-55)	123.8

65 Fed. Reg. 41551 (July 6, 2000).

TUBERCULOSIS. The APHIS has issued an interim regulation changing the status of Michigan from split-state status to nonmodified accredited status for the entire state. **65 Fed. Reg. 39780 (June 28, 2000)**.

FEDERAL ESTATE AND GIFT TAX

EXTENSION OF TIME TO PAY TAX. In a Chief Counsel's Advice letter, the IRS ruled that the IRS has the discretionary authority to require an I.R.C. § 6165 bond but not an I.R.C. § 6324A special lien as a condition to granting an extension of time to pay federal estate taxes, under I.R.C. § 6166. **CCA Ltr. Rul. 200027046, April 26, 2000**.

GENERATION SKIPPING TRANSFERS. The taxpayer had created three trusts for the taxpayer's children, with remainders to grandchildren. The taxpayer filed a gift tax return but made several errors in the allocation of the contributions to the trusts which were subject to GSTT and failed to include a Notice of Allocation of GST Exemption. However, the return did indicate that the taxpayer intended to allocate the GST exemption to the trusts such that the exclusion ratio was zero. The taxpayer made additional contributions to the trusts five years later and included a late "protective" allocation of the exemption for the earlier contributions. The IRS ruled that the initial return substantially complied with the regulations and that the taxpayer would be allowed to allocate the portion of the gifts sufficient to create an exclusion ratio of zero. **Ltr. Rul. 200027009, March 31, 2000**.

After settlement of a suit against the estate, estate property passed to a grandnephew and grandniece of the decedent. The parents of the grandnephew and grandniece predeceased the decedent and the decedent had no other living descendants. The IRS ruled that the grandnephew and grandniece would be considered one generation lower than the decedent for GST purposes. **Ltr. Rul. 200026001, Ltr. Rul. 200026002, Ltr. Rul. 200026003, Ltr. Rul. 200026004, March 3, 2000**.

IRA. The decedent died owning two IRAs. The named beneficiary of the IRAs was the decedent's estate. The decedent's will was made before marriage to the surviving spouse and did not contain any bequests to the surviving spouse. Under state inheritance law, in such cases, the surviving spouse is entitled to a one-half share of the estate. The estate distributed one-half of each IRA to the surviving spouse who contributed the funds to IRAs in the spouse's names. The IRS ruled that the IRA funds would be treated as received from the decedent and not the decedent's estate; therefore, the funds would not be included in the surviving spouse's income. **Ltr. Rul. 200027061, April 12, 2000**.

TRUSTS. The IRS has adopted as final regulations governing application of the grantor trust rules to foreign trusts with United States persons as beneficiaries. The regulations provide for taxation of U.S. beneficiaries of amounts distributed by foreign trusts to intermediaries prior to being distributed to the U.S. beneficiary. The regulations remove some foreign trusts from the grantor trust rules in order to allow taxation of the beneficiary for distributions from trusts established by foreign persons. **65 Fed. Reg. 41332 (July 5, 2000)**.

VALUATION. The decedent had created an intervivos trust with the decedent as income beneficiary and the decedent's two children as remainder beneficiaries. The trust and the children entered into a partnership agreement with the trust receiving a limited partnership interest in exchange for contribution of the trust corpus. The limited partnership interest was divided into two classes, with 60 percent transferred to the children and 39 percent retained by the trust. The partnership agreement provided for dissolution of the partnership if (1) either of the general partners leaves the partnership and the remaining general partner does not elect to continue the partnership, or (2) all partners agree in writing. The general partners cannot withdraw from the partnership without the consent of the limited partners. The court held that the facts were similar to those in *Kerr v. Comm'r, 113 T.C. 449 (1999)* and the California partnership law in this case was similar to Texas partnership law in Kerr; therefore, the court followed the holding in *Kerr* that the partnership agreement was not more restrictive than state law. The court held that the limitations on liquidation contained in the partnership agreement were not applicable restrictions within the meaning of I.R.C. § 2704(b) and must be taken into account in valuing the limited partnership interests for estate tax purposes. **Estate of Harper v. Comm'r, T.C. Memo. 2000-202**.

The decedent's estate included a 25 percent interest in a partnership. The estate had valued the interest using discounts for lack of marketability, lack of control, uncertain rights, and ownership of an undesirable mix of assets. Under Texas law and the partnership agreement, the decedent's death dissolved the partnership and the estate's interest in the partnership became an assignee's interest. The IRS argued that the discounts were not applicable because the estate had the right to a 25 percent interest in the liquidated partnership assets. The court held that, under Texas law, the other partners had the right to continue the partnership and pay the estate the value of the decedent's interest. The court held that the value of the decedent's interest under those circumstances would be the fair market value, determined using discounts for lack of marketability, lack of control, uncertain rights, and ownership of an undesirable mix of assets. **Adams v. United States, 2000-2 U.S. Tax Cas. (CCH) ¶ 60,379 (5th Cir. 2000), aff'g, 99-1 U.S. Tax Cas. (CCH) ¶ 60,340 (N.D. Tax. 1999).**

FEDERAL INCOME TAXATION

BREEDING FEE. The taxpayers operated a racehorse raising and racing activity. The taxpayers had entered into a breeding agreement and claimed the breeding fee as a current expense. The breeding agreement guaranteed the taxpayers a live foal. The court held that the breeding fee had to be capitalized in the cost of the foal, allowing only the depreciation deduction. See also more on this case under Hobby Losses, *infra*. **Jordan v. Comm'r, T.C. Memo. 2000-206**.

DISASTER PAYMENTS. On June 23, 2000, the president determined that certain areas in Wisconsin are eligible for assistance under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, as a result of severe storms and flooding on May 26, 2000. **FEMA-1332-DR**. On June 27, 2000, the President determined that certain areas in Minnesota are eligible for assistance under the Act as a result of severe storms on May 17, 2000. **FEMA-1333-DR**. On June 27, 2000, the President determined that certain areas in North Dakota are eligible for assistance under the Act as a result of severe storms and flooding on June 12, 2000. **FEMA-1334-DR**. Accordingly, a taxpayer who sustained a loss attributable to the disasters may deduct the loss on his or her 1999 federal income tax return.

HOBBY LOSSES. The taxpayers, husband and wife, owned a 20 acre farm on which they lived. The taxpayers owned six broodmares which they used as racehorses. The taxpayers also intended to breed the horses with other racehorses owned by other persons and to raise the resulting foals to be racehorses. The primary source of income was to be from race purses. The husband had fulltime employment elsewhere for a modest salary and the wife worked fulltime at the racehorse activity. The taxpayer did not keep separate books but had some written evidence of their claimed expenses. A major expense for the tax year involved was the remodeling of a barn. Although the court acknowledged the nine factors in Treas. Reg. § 1.183-2(b), the court did not specifically discuss all of the factors. The court focused instead on the highly speculative nature of horseracing and concluded that the taxpayers would have no reason to pursue the activity without a profit intent; therefore, the court held that the taxpayers entered into the activity with the intent to make a profit. However, the court denied a current deduction for the remodeling costs of the barn, holding that those costs had to be capitalized and deducted under the depreciation rules. The court also denied several other expense deductions as not reasonable and necessary to the horseracing activity. The taxpayers had claimed all of the mortgage interest as a business deduction, which the court held was not deductible, even in part, because the horseracing activity did not have any income in the tax year involved. **Jordan v. Comm'r, T.C. Memo. 2000-206.**

IRA. The IRS has announced a new method to be used for calculating the net income attributable to IRA contributions made after 1999 that are distributed as a returned contribution pursuant to I.R.C. § 408(d)(4) or recharacterized pursuant to I.R.C. § 408A(d)(6). The IRS has received comments that the old method for calculating net income attributable to an IRA contribution often did not reflect the actual earnings and losses of an IRA during the time it held the contribution, because, under the old method, account activity in the part of the year that preceded the date the contribution was made was taken into account in the calculation of the net income attributable to the contribution. In addition, IRA owners and other interested parties indicated that net income should be permitted to be a negative amount. In response to these comments, the IRS is providing a new method for calculating net income that generally bases the calculation of the amount of net income attributable to a contribution on the actual earnings and losses of the IRA during the time it held the contribution. Until further guidance is issued, net income may be calculated under either the new method or the old method. **Notice 2000-39, I.R.B. 2000-__**.

PASSIVE ACTIVITY LOSSES. The taxpayer was a dentist who operated the practice through a personal services C corporation. The corporation leased the business building from the taxpayer's spouse. The lease was started in 1979 and had a term of three years, but at the end of the term the lease was amended to allow the lease to continue year-to-year and to give each party the right to terminate the lease with a 90-day written notice and to allow the rent to be increased each year. The taxpayers claimed the rental income from the building as passive income and used the income to offset passive losses from other sources. The court held that the regulations in 1993-1994 provided that if the landlord was the sole shareholder of a C corporation and materially participated in the corporation's business, the rental income from the corporation was nonpassive income. The court also held that the lease was not exempt from the regulations as a pre-existing binding contract, because the lease was unenforceable under state law when the regulations were promulgated. **Connor v. Comm'r, 2000-2 U.S. Tax Cas. (CCH) ¶ 50,560 (7th Cir. 2000)**.

RETURNS. The taxpayers, husband and wife, filed a joint return and listed their minor children as dependants. The taxpayers, however, did not include any social security numbers (SSN) for the children because the taxpayers objected, on religious grounds, to the use of universal identifiers. The IRS agreed that the religious objection was sincere and that the minor children were eligible dependants, but denied the personal exemption for the children, based on the failure to provide the social security numbers. The taxpayers argued that they should be allowed to use individual taxpayer identification numbers (ITIN) for the children. The court held that the SSN requirement fulfilled a compelling governmental interest because the use of ITINs for persons not exempt from social security taxes could increase the chances of fraudulent returns by persons who also acquire SSNs. **Davis v. Comm'r, T.C. Memo. 2000-210**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

DISCHARGE OF INDEBTEDNESS. The taxpayer held a 25 percent interest in an S corporation which had discharge of indebtedness income. The corporation was insolvent and filed for bankruptcy; therefore, the discharge of indebtedness income was excluded from the corporation's income under I.R.C. § 108(a). The taxpayer increased the stock basis by the taxpayer's share of the discharge of indebtedness income. The Tax Court cited its holding in *Nelson v. Comm'r*, *110 T.C. 114 (1998)*, to hold that discharge of indebtedness income excluded from an S corporation's income was not passed through to the shareholders to increase the basis of stock. The appellate court discussed the several decisions on both sides of the issue and held that an S corporation must first use any untaxed discharge of indebtedness income to reduce tax attributes at the corporate level before passing through any remaining discharge of indebtedness income to shareholders. In this case, the corporation had suspended losses which completely offset the discharge of indebtedness income, leaving no discharge of indebtedness income to pass through to the shareholders. In addition, the offset suspended losses were not passed through to the shareholders. **Gaudiano v. Comm'r, 2000-2 U.S. Tax Cas. (CCH) ¶ 50,559 (6th Cir. 2000), *aff'g*, T.C. Memo. 1998-408**.

DISREGARD OF CORPORATION. The taxpayers, husband and wife, originally formed a partnership which owned and operated a commercial rental property. In order to limit their liability for the business, the taxpayers incorporated the partnership and elected S corporation status. The taxpayers wanted to transfer the commercial property and the loan on that property to the S corporation but decided not to transfer the property because the lender would have charged them $10,000 for the transfer. However, the S corporation treated the loan and property as belonging to the corporation on the corporation's tax returns for four tax years. In the fourth tax year, the taxpayers claimed flow through losses from the corporation. The IRS disallowed the losses to the extent the losses exceeded the taxpayers' bases in the corporation, excluding the loan amount for the commercial property because the corporation was not liable for the loan and did not own the property. The taxpayers argued that the corporation should be disregarded, with the operation treated as a partnership, so that the loan amount was added to their basis in the business. The court held that the corporation would not be disregarded for federal income tax purposes because (1) the corporation filed tax returns for four years and represented on those returns that it owned the property and was liable on the loan; (2) the corporation had a business purpose to limit the taxpayers' tort liability; and (3) the corporation was not acting as an agent for the taxpayers. The taxpayers also argued that the IRS was equitably estopped from denying the corporation's ownership and loan liability because the IRS did not object to the corporation's first two tax returns. The court held that the IRS was not precluded from challenging later returns merely because no challenge was raised in earlier years. **Jeyapalan v. Comm'r, T.C. Memo. 2000-207**.

MORE THAN ONE CLASS OF STOCK. The taxpayers were shareholders in an S corporation with one class of stock. The corporation issued one share of voting and 10 shares of nonvoting stock for each old share of stock. The shareholder rights were the same of each type of stock except for the voting rights. The IRS ruled that voting and nonvoting shares of stock did not create a second class of

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stock for S corporation status purposes. **Ltr. Rul. 200026011, Ltr. Rul. 200026012, March 28, 2000**.

SECURED TRANSACTIONS

DEFICIENCY PAYMENTS. The debtor had granted a purchase-money security interest in crops to be grown in 1999 along with the proceeds, insurance proceeds and government payments from the crop. The crop was planted but before it was harvested the debtor filed for Chapter 12. The crop was harvested post-petition and the debtor applied for and received loan deficiency payments (LDPs) from the CCC. The debtor argued that the LDP payments was not subject to the security interest under Section 522 because the debtor had no right to the LDP until the debtor harvested the crop post-petition. The court held that the debtor's right to participate in the program existed prepetition and was sufficient right to the payment for the security interest to attach. ***In re*** **Otto Farms, Inc., 247 B.R. 757 (Bankr. C.D. Ill. 2000);** ***In re*** **Klaus, 247 B.R. 761 (Bankr. C.D. Ill. 2000)**.

DISASTER PAYMENTS. The debtors had granted to a bank a security interest in "the proceeds from any crop loans, payments, or subsidies paid or guaranteed by any governmental entity, agency or subdivision." On April 22, 1999, the FSA issued a report that the debtors were eligible for crop loss disaster payments for 1998. On May 5, 1999 the debtors filed for Chapter 12 and filed for the disaster payments after filing the bankruptcy petition. The debtors argued that the antiassignment provision in the disaster payment regulations prevented the bank's security interest from attaching to the disaster payment. The court held that federal regulations could not preempt state security interest law. The debtors also argued that the security interest did not attach to the proceeds until after the bankruptcy petition; therefore, the security interest, under Section 552, did not reach the disaster payment. The court held that the debtors has sufficient rights in the collateral for the security interest to attach prepetition. The court held that the FSA report established the debtors' right to the disaster payments and that the post-petition action application was only an administrative formality to receive the payments. **In re Norville, 248 B.R. 127 (Bankr. C.D. Ill. 2000)**.

STATE REGULATION OF AGRICULTURE

CORPORATE OWNERSHIP OF FARMLAND. The defendant corporation was owned by one person and operated a hog confinement facility since 1990. The owner handled the business strategy, finances, employment, marketing, herd health and overall management of the corporation's business. The day-to-day on-site operations were the responsibility of a hired manager who lived on the farm. The manager supervised the employees, execution of the feeding operations and maintenance of the facility. Under the Nebraska Constitution, article XII, § 8, for-profit corporations may not own real estate used for farming unless an owner of 50 percent or more of the stock either resides on the farm or engages in the day-to-day labor and management of the farm. The issue was whether the shareholder engaged in the day-to-day labor and management of the farm. The court focused on the activities that took place on the farm, the feeding, handling and nurturing of the hogs and found that the shareholder did not participate in these activities; therefore, the court held that the shareholder did not engage in the day-to-day labor and management of the farm and the corporation's ownership of the farm violated the Nebraska constitution. The court also rejected the defendant's argument that the prohibition violated the Equal Protection clause of the U.S. Constitution. The court held that the prohibition was not unconstitutional because it was rationally related to a legitimate state purpose of promoting family farming. **Hall v. Progress Pig, Inc., 610 N.W.2d 420 (Neb. 2000)**.

GENETICALLY MODIFIED ORGANISMS. The Colorado Supreme Court has rejected a challenge to a ballot initiative which would require the legislature to enact laws and provide funding for the labeling of food containing genetically modified substances. **Brown v. Peckman, No. 00SA194 (Colo. July 3, 2000)**.

STATE TAXATION

TRUSTS. The taxpayers were the members of one family, husband and wife and three children. The parents attended a "financial planning" seminar, purchased a trust kit, and transferred their 500 acre farm to a trust in exchange for certificates of beneficial interest for themselves and their children. Much of the farm was then surveyed and subdivided into residential lots. In reporting gain from the sale of the lots, the trust determined the tax basis to be the fair market value of the lots when the farm was transferred to the trust. The parents continued to operate the farm and the development of the residential lots and continued to live on the remaining farm property. The court held that the trust income was the personal liability of the parents because the trust was a sham as a business trust, because property was transferred to the trust in exchange for certificates of beneficial interest which closely resembled stock, (2) the certificates of beneficial interest were easily transferable, (3) the owners of the property continued to exercise substantial control over the property, and (4) the trust had a continuity of life more resembling a corporation. The court also determined that the tax basis of the lots was the basis of the lots in the hands of the parents prior to the transfer to the trust. **Ruby Mountain Trust v. State, 2000 WL 821727 (Mont. 2000)**.

CITATION UPDATES

In re **Cousins, 209 F.3d 38 (1st Cir. 2000),** ***rev'g*****, 238 B.R. 503 (D. N.H. 1999),** ***aff'g*****, 236 B.R. 119 (Bankr. D. N.H. 1999)** (post-petition interest) see p. 67 *supra*.

Holland v. United States, 94 F. Supp.2d 787 (S.D. Texas 2000) (court awards and setlements) see p. 94 *supra*.

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